

Conservation Easements: Rewards for Stewardship

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The Challenge to Landowners

Managing forestland with a long-term perspective is challenging for any landowner. This is especially so for nonindustrial private forest landowners (NIPFs), a class of landowners who typically manage for multiple resources and values.

Forests are complex, dynamic natural systems structured through time by large and small disturbances. They are likely to contain not only a diversity of tree species, but also an array of flora and fauna we are only beginning to understand. Further, many dominant tree species reach their biological maturity well after any particular landowner has completed his or her particular lifetime. From this complexity NIPFs seek to derive economic and noneconomic benefits through time. Those NIPFs who take up the challenge of long-term, multi-resource forest management are honored as "forest stewards" and "master woodlot owners." They seek to protect both private and public resource values. They exceed best management practices required by law.

But is such excellent stewardship its own reward? How can NIPFs manage for noncommodity forest resources and still pay the mortgage or send the kids to college? How can more NIPFs overcome obstacles to managing for long term forest productivity? In this paper we will explore these obstacles and provide some suggestions for incentives to overcome them, with a focus on conservation easements.

What Hurdles to Stewardship Do NIPFs Face?

Numerous hurdles lie in the way of NIPFs achieving higher levels of forest stewardship. While many NIPFs find that multi-resource management, stand improvement investments, resource conservation activities, and other "stewardship" endeavors do pay for themselves through greater returns on their forest property, others find the up-front cash requirements or deferral of income daunting.

Briefly, we would like to summarize the primary hurdles to stewardship:

- ▶ Lack of knowledge of forestry, especially for multi-resource management, forest ecology, and other advanced forest research.
- ▶ The time value of money, especially considering the growth period required for many major commercial species to attain high quality age classes and biological maturity.
- ▶ Tax burdens that can generate premature or excessive timber harvests, e.g., ad valorem property, estate, and income taxes.

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- ▶ Lack of financing, especially for planning, precommercial management activities, road maintenance and decommissioning, and resource conservation such as erosion control and water quality improvements.
- ▶ Lack of liquidity between harvests, that is, cash today against timber harvests 20 to 30 years in the future.

What Help Exists for NIPFs? What New Incentives for Stewardship Are Needed?

While others have dealt with this topic in depth, we would like to briefly review the sources of existing help for NIPFs, emphasizing areas that should be expanded or reformed.

Expanded educational outreach and technology transfer

In spite of many advances in forest management in the last ten years, information on ecologically sustainable, multi-resource forest management practices and harvest systems is still not well distributed or demonstrated. Programs such as the USDA Forest Service's Forest Improvement Program (FIP) and Stewardship Incentives Program (SIP), as well as university cooperative extension and other resource management outreach programs, need to be expanded to better support NIPFs in the planning and implementation of multi-resource forest management and forest resource conservation.

Cost-share for forest stand improvements and resource conservation

Cost-share funds through the US Department of Agriculture, US Department of the Interior, and state programs should include or expand eligibility of forest stand improvement, erosion control, streambank stabilization, road decommissioning, and other forest resource conservation activities. These are investments in both future forest productivity and public trust values such as water quality and habitat.

Tax reform

A number of current tax policies and regulations penalize forest stewardship, especially with regard to growing and holding older age classes of trees and accounting for annual maintenance and restoration expenses. In those states that still retain it, the ad valorem property tax should be eliminated in favor of a severance tax system based on current forest use. Capital gains and severance taxes should be structured to encourage the harvest of desired age classes of trees, and to help offset both the time value of money and accrued inflationary impact on profits that discourages the growing of older trees. Expenses for restoration, enhancing structural diversity, developing nontimber forest products and annual road maintenance should be eligible for either annual expensing or speedier amortization so their recapture is not limited to harvest time.

Regulatory streamlining

The combination of public resource conservation mandates that have grown in recent years and lack of coordination among government agencies with resource management responsibilities is a source of confusion and added cost to NIPFs. Providing "one-stop shopping" for NIPFs among federal and state regulatory agencies would help. In addition to bundling such programs in a customer-friendly fashion, NIPFs should be given assistance with multi-resource planning. Based on such plans, multiple permits could be more smoothly issued. Further, landowners willing to make the commitment to long-term stewardship through conservation easements or other long-term contracts should receive some promise of regulatory stability, as well as preferential access to technical assistance and cost-share programs.

Market development and access

Lack of access to markets for particular timber and nontimber products can also be a barrier to higher levels of forest stewardship for NIPFs. Enhancing revenue from every timber harvest and developing compatible nontimber revenues will increase the profitability of ecosystem management in general, and

stabilize NIPF income streams. Such diversification rewards landowners for stewardship. Access to multiple log buyers, creation of cooperative log merchandising yards, and development of special forest products marketing are among the means through which NIPFs can maximize returns on the forest products they harvest. Access to emerging markets for nontimber forest products—from mushrooms to carbon storage services—is of increasing relevance to NIPFs since they have the flexibility to produce multiple goods and services. Existing federal, state, and local economic development programs directed at forest regions should be refocused to include improved market access.

Conservation easements

These are practical and flexible incentives for multi-resource forest management that deserve wider application on working forestlands. NIPFs whose stewardship practices exceed the requirements of law can be rewarded through the sale or donation of such easements. Conservation easements are a means to overcome tax barriers as well as to receive compensation for noncommodity resource management, as described further below.

Conservation Easements: Effective Existing Incentives

Conservation easements have been in use since the 1930s, though they did not attain widespread attention until the 1960s. Land trusts manage more than 750,000 acres under conservation easements in the United States today. Most conservation easements have been placed in the last 20 years since the Internal Revenue Code was amended to explicitly provide for the deductibility of gifts of qualified conservation easements.

Through the sale or charitable donation of a conservation easement, a landowner is compensated for his or her voluntary commitment to conservation. Conservation easements are attractive land conservation tools because this approach maintains private ownership and control of the property, rather than requiring its sale. While most conservation easements have been utilized to maintain open space (especially with farmland), create habitat set-asides, or protect scenic views, the use of conservation easements on working forestland is a relatively recent and growing phenomenon.

Conservation easements are appealing to NIPFs because they can help protect carefully stewarded forest capital from liquidation through unwanted over-harvesting and parcelization of the property. By limiting land uses to compatible forest uses and by restricting the rate and character of timber harvest, the reduced appraised property value can help NIPFs keep the forestland in the family through reducing estate taxes.

With the ownership of property comes the right to do, or not do, many things: develop new lots, build residential and other structures, utilize water, farm, harvest timber, etc. Most landowners are protective of their property rights and desire to maintain their options for a range of land uses. Others wish to maintain the ability to utilize their land as they are already doing. The right to limit development on land has been called by some the “Lost Property Right.” Landowners can utilize conservation easements to protect their forest assets by stripping off speculative rights that raise their taxes but provide no income. All rights not restricted by them in the easement are available for use, balancing conservation with economic gain.

What Is a Conservation Easement, Exactly?

A conservation easement is a permanent deeded restriction placed on the forestland by the landowner. Its terms define and limit the kind of development and use that can take place on the property. The purpose of the easement is specifically defined for each property, but generally must allow for the protection of certain natural values that have been identified as having public benefit, such as open space or fish and wildlife habitat. The landowner grants the easement to a government entity or nonprofit land trust to monitor and enforce through time. The grantee organization has the responsibility to ensure that the restricted rights are not exercised but are “held in trust” for the public.

Conservation Easements vs. Regulation

Conservation easements are voluntary restrictions on land use placed on the property by its owner. They are not imposed by a governmental authority or third party. Conservation easements establish standards of management above and beyond those required by law. They are cooperative agreements between the landowner and the grantee organization that are jointly designed. As such, unlike regulation, conservation easements are flexible and site-specific, not one-size-fits-all.

Land Trusts: Holding Natural Capital in Trust for Future Generations

Most conservation easements are granted by landowners to charitable nonprofit conservation organizations known as “land trusts” or “land conservancies.” They are nongovernmental corporations and are governed by a volunteer board of directors. Their primary purpose is serving landowners and the general public to conserve land and resources that have been identified as being in the public interest. Land trusts work with landowners in a private fashion, becoming a partner chosen to ensure the landowner’s vision of forest stewardship in perpetuity.

How Is a Conservation Easement Established?

If a landowner such as a NIPF approaches a land trust about establishing a conservation easement, a process of mutual research, analysis and goal setting ensues. This process can take six to twelve months or longer to complete, depending on the circumstances. Together the landowner and land trust jointly review the subject property’s significant characteristics and identify the specific “conservation values” that are considered of public benefit, warranting protection through a conservation easement. From this research and analysis a general conservation plan is devised which reflects the landowner’s goals for management and conservation of the property’s resources. Based on this conservation plan the actual terms of the legal deed of conservation easement are drafted to the agreement of both parties. At the same time, a “baseline report” is researched and written, documenting the property’s characteristics at the time the easement is being granted. The baseline report becomes the point of reference against which future easement monitoring is compared. When the deed of conservation easement is executed, it is then recorded in the county where the property is located.

From that point on, the grantee land trust carries the liability of monitoring and enforcing the terms of the easement on behalf of the grantor. To fund this perpetual obligation, typically the granting landowner makes a provision for a contribution to a stewardship fund, the earnings from which offset the annual monitoring expenses of the land trust.

Qualifications for Tax Deductibility

Conservation easements are the only gift of partial interest in property that can be tax deductible. For the donation of a conservation easement to qualify for tax deductibility, the IRS has established certain standards in Section 170(h) of the Internal Revenue Code. According to the Code, the conservation easement must meet one or more conservation benefit tests of particular relevance to forestland. The terms of the easement must restrict land use to:

Protect habitats or ecosystems; and/or

Preserve open space pursuant to government policy or for scenic enjoyment of the general public.

Conservation easements can also be given to provide for public education or recreation, or to protect historic sites. Further, to merit tax deductibility, the conservation easement must be donated to a qualified nonprofit 501(c)(3) land trust or government agency and the easement must be in perpetuity.

There are further provisions of the Code and the relevant Treasury regulations that NIPFs should familiarize themselves with in considering the establishment of a conservation easement on their property. Landowners should consult with their legal and tax advisers to receive professional advice in their consideration.

Typical Provisions of a Conservation Easement

Conservation easements on working forestland will typically contain provisions that prohibit nonforest uses and also guide on-going forest management to ensure the conservation values of the property are protected. In general, such a conservation easement will:

- ▶ Dedicate the property to compatible forest uses;

Limit or prohibit subdivision or parcelization to maintain economic management size and minimize habitat fragmentation;

Prohibit residential development or limit its scale and impact on the forested areas of the property;

Restrict timber harvesting to meet resource conservation goals, e.g., protection of riparian habitat, enhancement or restoration of habitat (including for threatened and endangered species), water quality improvements, maintenance or restoration of biodiversity, older age classes of trees, etc.; and

Protect other identified “public benefit” resources mutually agreed-upon, e.g., scenic, recreation, historic values.

How Are Conservation Easements Valued?

Whether a conservation easement is charitably donated or sold to the grantee organization, its value will need to be appraised. This should be done by an independent professional appraiser with demonstrated experience in appraising the same sort of property. The methodology most commonly used is to first establish the unencumbered property value and then the encumbered. The values are compared and the difference becomes the easement value. With working forestland, that value typically corresponds to the opportunity cost of any agreed-upon forest management restrictions and the value of foregone development.

Compensation for Conservation

The conservation easement value becomes a means to appraise the cost of managing for noncommodity resources like habitat or water quality. These are difficult to measure directly, but can be quantified indirectly through valuation of income given up or deferred through the restrictions of the conservation easement. Once that value is determined, the granting landowner receives either income or income tax benefits, as well as estate tax deductions commensurate to the value of the conservation easement. Until such time as markets develop for such noncommodity resources, there are virtually no other opportunities for a NIPF to be compensated for a long-term commitment to conservation without actual sale of fee title to the property.

To the degree that there is funding available for the purchase of conservation easements, these acquisitions take place almost entirely through the very limited monies available through government programs, such as the USDA Forest Service’s Forest Legacy or Maine’s Land for the Future. Private funds for conservation easement acquisition is even more modest. There are new initiatives being taken by organizations such as the Pacific Forest Trust to provide novel funding for conservation easements. Through their Forests Forever Program, the Pacific Forest Trust will use conservation easements to establish permanent carbon “sinks” to reduce the threat of global warming. The funding for these “carbon easements” will be provided by private companies whose activities contribute carbon dioxide to the atmosphere.

Conservation Easements Can Reduce or Eliminate Estate Taxes

NIPFs cite the impact of estate taxes on their forestland as one of their greatest concerns. Often the heirs to forestland are compelled to prematurely or excessively harvest their timber, or sell their property, to meet the estate tax obligation. A contributing factor to the estate tax burden on forestland is that in the settlement of an estate, the IRS appraises forestland at its greatest liquidation value or “highest and best use,” not its current forest use. Highly appreciated timber and trees are valued as if they were to be completely sold in an orderly fashion. This form of valuation can place many NIPF families in a high estate tax bracket, sometimes quite unexpectedly.

By having placed a conservation easement on the family forestland, the NIPF reduces the estate value by eliminating development rights that he or she doesn’t intend to utilize. The estate’s forestland is then valued only for its forest uses. Conservation easements can be used in combination with most estate planning tools to maximize benefits and “zero out” estate taxes. Families in the process of “succession planning” should consider the potential benefits of conservation easements. Conservation easement can be donated “inter vivos,” or in the lifetime of the donor, or as a testamentary gift through the donor’s will; however, they cannot be donated post mortem by the executor with the hope of reducing the estate taxes.

An Example from the Pacific Northwest of the Use of a Conservation Easement

Two sisters in their sixties own 700 acres of coastal Douglas fir forestland. It was purchased by their parents in the 1920s and since then both timber and land values have appreciated greatly. This property represents the largest single asset of the family. The average stocking is 30,000 bf/acre at this time. The sisters’ management goals are for on-going periodic income, family recreation, and the maintenance of one residence on the property.

Conservation easement terms for the “two sisters”

Together the two sisters and their heirs determine that the conservation easement should prohibit subdivision, more building, and clearcutting of the property. They want to maintain harvesting timber at about the same level they have been, ensuring that inventory levels are not depleted, so they limit timber harvest to 20 percent of inventory per decade. They also want to protect the salmon stream that runs through the property and enhance forest structure for habitat, so they add some restrictions relating to riparian zones, steep slopes, and maintenance of snags and woody debris.

Evaluating the financial impact of the conservation easement in our example

The “Before” value of the property is appraised at \$12 million (\$1 million in land and \$11 million in timber). Taking into consideration the effect of the conservation easement, the “After” value is determined to be \$5 million (\$500,000 in land and \$4,500,000 in timber). Therefore, the reduction in the estate appraisal will be \$7 million and the corresponding reduction in estate taxes is \$3.8 million. The remaining estate tax payable of \$2.1 million can then be met through the restricted timber harvest.

Additional tax benefits for the “two sisters”

For the two sisters, the gift of the \$7 million conservation easement to a qualified land trust provides a major charitable income tax deduction as well. This charitable tax deduction could be applied against up to 30 percent of their adjusted gross income, and can be carried forward five years. If the donation is made in their lifetime and is timed well, it can be applied against timber harvest receipts or any income.

Rewards for Stewardship

NIPFs typically own their land for many reasons, including both timber and nontimber uses and values. Conservation easements are attractive incentives for many NIPFs because this tool can help them accomplish their multiple goals, providing both on-going management guidance and often significant financial

benefits. Conservation easements are among the few rewards available to NIPFs committed to long-term forest stewardship.

Roll Out the Red Carpet: More Incentives for Stewardship

Given that conservation easements encumber a property's title, they are the greatest expression of long-term commitment to forest stewardship a NIPF can make. Current use valuation contracts, conservation reserve agreements, habitat conservation plans, and other forest resource conservation methods are term limited or require renewal. While all these incentives bring benefits to the landowner in terms of some compensation, tax or regulatory relief, or improved productivity, only conservation easements are permanent. The public benefits that accrue from this use of taxpayer's money will never be lost.

Not only are conservation easements permanent, their terms always exceed the standards set by law. So shouldn't NIPF grantors be recognized further for their excellent stewardship? Conservation easements granted by NIPFs that protect public resource values like habitat and water quality, while maintaining productive use and contributing to regional economic stability, should be eligible for streamlined and simplified regulatory review for compliance with state forest practice acts and federal environmental legislation, such as the Endangered Species and Clean Water Acts. NIPF grantors should also receive preference for government cost-share and technical transfer programs. It's time we "rolled out the red carpet" for such forest stewards.